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No. 82-620 and No. 82-622

IN THE

Supreme Court of the United States

October Term, 1982

No. 82-620

W. JAMES PRICE, ALONZO G. DECKER, JR., JAMES PARKER NOLAN, FREDERICK DEANE, JR., JAMES L. O'KEEFE, GREGORY S. DEVINE, FAY A. LeFEVRE, JOHN K. STEVENSON, HAYS T. WATKINS and HOWARD E. SIMPSON, *et al.*,

Petitioners,

vs.

PITTSBURGH TERMINAL CORPORATION,

Respondent,

and

W. JAMES PRICE, *et al.*,

Petitioners,

vs.

MONROE GUTTMANN, LORETTA GUTTMANN, JANET REES and EVELYN BITTNER,

Respondents.

(Additional Actions inside front cover.)

RESPONSE TO WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Respondents.

Counter Statement of the Questions Presented

I. Whether, under §10(b) of the Exchange Act and Rule 10b-5:

A. A defense of advice of counsel may rest on unwritten opinions of Defendants' in-house lawyers who never considered those provisions?

B. Alleged reliance on advice of counsel is a defense negating scienter?

II. Whether Defendant issuing corporation and its majority shareholders and directors breached a duty to convertible debentureholders by depriving them of a meaningful opportunity to exercise their conversion rights through concealment of the impending MAC dividend?

A. Whether an Indenture notice clause referring to "any dividend on [the issuer's] common stock payable in stock" required advance notice to convertible debentureholders of a dividend on the issuer's stock, payable in stock of a subsidiary of the issuing company?

B. Whether, for purposes of Rule 10b-5, Rule 10b-17 entitles holders of publicly traded debentures to advance notice of dividends on the issuer's stock?

III. Whether this Court's opinion in *Blue Chip Stamp v. Manor Drug Stores* (holding that the owner of a contractual right to purchase has standing to sue under §10(b) and Rule 10b-5) was correctly applied?

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Counter Statement of the Case

A. Background Facts

This action, asserting in part violations of the Securities Exchange Act of 1934, arose from the December 1977 declaration of a dividend payable in the stock of Mid-Allegheny Corporation ["MAC"] to common shareholders of Defendant, The Baltimore and Ohio Railroad ["B&O"]. The dividend was declared without prior notice to Plaintiffs, holders of certain B&O convert-

ible debentures, so as to deprive them of the opportunity to exercise their conversion rights and thereby to share in the MAC stock dividend. The Defendants include the B&O; its controlling shareholders, the Chesapeake & Ohio Railroad Company ["C&O"] and the Chessie System, Inc. ["Chessie"]; and fourteen Directors of the B&O.

Plaintiffs own B&O 4-1/2% debentures, which are convertible into 10 shares of B&O common stock for each $1,000 debenture.

Simultaneous with the declaration of the MAC dividend, the B&O transferred substantially all of its non-rail assets to MAC, a wholly owned subsidiary.[1] In declaring the dividend, the Defendant Directors of the B&O set the record date as the date of declaration. The possibility of Plaintiffs converting so as to receive the dividend, and thereby participate in the development of the non-rail assets of the B&O, was thus foreclosed. Concealment of the impending declaration of the MAC dividend enabled the B&O's parent and grandparent, the C&O and the Chessie, to upstream those extremely valuable assets, beyond the reach of the convertible debentureholders.

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[1] Of the outstanding 2,535,772 shares of B&O common, 99.9% were owned by the C&O whose outstanding stock was 100% owned by Chessie. Twelve (12) of the fourteen (14) Directors of the B&O were also Directors of Chessie and the C&O. The Chairman of the Board of the B&O was Chairman of the Boards of the C&O and Chessie. All the executive officers of the B&O held the same position in the C&O and Chessie.

B. Procedural History

On December 28, 1977, Plaintiff, Pittsburgh Terminal Corporation ["PTC"] commenced an individual action against the Defendant B&O and others to enjoin the payment of the December 1977 MAC dividend. On March 7, 1978, the Trial Court granted Plaintiff PTC a preliminary injunction. See 466 F.Supp. 656 (W.D.Pa. 1978). That injunction was subsequently reversed by the Court of Appeals on July 5, 1978, because Defendant B&O offered to put aside sufficient shares of MAC stock to satisfy Plaintiff's claim. See 578 F.2d 1375 (3d Cir. 1978). On remand, Plaintiff PTC, on February 15, 1979 filed an amended complaint expanding its causes of action and adding a claim for monetary damages. The amended complaint was similar to the complaint filed by PTC's President Monroe Guttmann and others on January 22, 1979.

Following a trial, the Trial Court on March 10, 1981 entered judgment in favor of the Defendants. See 509 F.Supp. 1002 (W.D.Pa. 1981). On June 3, 1982 the Court of Appeals, in a 2 to 1 decision, reversed and remanded for determination of an appropriate remedy. See 680 F.2d 933 (3d Cir. 1982). Thereafter, on July 9, 1982 Defendants' petition for rehearing *en banc* was unanimously denied.

The Corporate and Director Defendants filed separate petitions for writ of certiorari. Because the issues raised by all petitioners are substantially the same Plaintiffs make this their response with respect to both petitions.

REASONS FOR DENYING THE WRIT

Summary of Argument

This case raises no exceptionally unusual or difficult issues appropriate for disposition by this Court. The Courts of Appeals are not in conflict over the questions raised herein, nor does the Court of Appeals' decision conflict with any decision of this Court. The allegedly "conflicting" decision of the Fifth Circuit is readily distinguishable.

At most, Defendants' petitions present yet another opportunity for this Court to restate the scienter standard of *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the duty standard of *Chiarella v. United States*, 445 U.S. 222 (1980) and the purchaser-seller standard of *Blue Chip Stamp v. Manor Drug Stores*, 421 U.S. 723 (1975). This Court has already given ample direction as to these issues. On its undisputed facts, the present case does not call for a reassessment of such well-established principles.

I. Defendants' acquisition of the MAC stock by concealment and in a manner designed to exclude the minority securityholders violated §10(b) of the Exchange Act.

The result of Defendants' conduct and concealment of the declaration of the MAC dividend was that the Defendant Chessie immediately became enriched by that portion of MAC which otherwise would have accrued to debentureholders who would have converted had they been timely and adequately informed. The Appellate Court held, on the facts as found by the Trial Court after

a five (5) day trial, that Defendants' conduct "was a manipulative or deceptive device or contrivance in violation of Section 10(b)" (22a). This ruling is fully supported by Defendants' admissions that:

> Defendant B&O did not reveal the prospect or possibility of a dividend payment to those who made inquiry concerning the prospects of such dividend payment in 1977.
>
> The prospect or possibility of the payment of a dividend on B&O common stock as part of the Chessie System Corporation Restructuring plan was known to B&O management at the time B&O received inquiries from Plaintiff and other holders of B&O convertible debentures in 1977 about the prospects of dividend declaration by B&O on its common stock.
>
> No attempt was made by Defendants to inform the public holders of the debentures of the proposed declaration of the MAC dividend prior to December 13, 1977.

In fact:

> No provision [ever] was made in the Chessie System Corporation Restructuring Plan [Note this was not the B&O's plan] for the issuance of Mid Allegheny Corporation stock to B&O convertible debenture holders who might convert their debentures to B&O stock
>
> See Request For Admission Nos. 24, 31, 42 and 57.

Significantly it is not disputed that "a reasonable [convertible debentureholder] *might* have considered [the prospect of a MAC dividend] of importance in the making of his [conversion] decision." See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 154-55 (1972). Advance disclosure of the MAC dividend with sufficient

opportunity for the debentureholders to convert their holdings to stock in time to receive the MAC dividend, would "have assumed actual significance in the deliberations of a reasonable" convertible debentureholder. See *TSC Industries, Inc. vs. Northway, Inc.*, 426 U.S. 438, 449 (1976).

In this Court Defendants seek to escape liability by pressing defenses, all found wanting below, of reliance on advice of counsel, absence of a duty to disclose, and lack of standing to sue. None of these arguments should detain this Court as demonstrated below.

A. Defendants' intentionally deceptive conduct is not excused by their claimed reliance on their in-house counsel who never considered §10(b) of the Exchange Act and Rule 10b-5.

Defendants argue that advice of counsel may in some circumstances constitute a defense to a §10(b) damage action. However, decision of that issue is not appropriate in the present case, since Defendants did not rely on the advice of disinterested counsel. In-house counsel did not consider the Exchange Act in connection with the MAC dividend and outside disinterested counsel were not retained to render a legal opinion on the MAC dividend.

Traditionally, the defense of reliance on the advice of counsel has been held pertinent only in equitable or disciplinary proceedings. *Securities and Exchange Commission v. Manor Nursing Homes Inc.*, 458 F.2d 1082, 1101-02 (2d Cir. 1972) and *Arthur Lipper Corp. v. Securities and Exchange Commission*, 547 F.2d 171, 182 (2d Cir. 1976) *cert. denied* 434 U.S. 1004 (1978).

In an equitable or disciplinary proceeding, the defendant has been required to satisfy at least five pre-

requisites in order to establish the defense, including that he (i) relied upon the advice of disinterested counsel; (ii) made complete disclosure of all relevant facts to counsel; (iii) requested counsel's advice as to the legality of the proposed conduct; (iv) received advice that such conduct was lawful; and (v) acted in accordance with such advice after it was rendered. See Hawes & Sherrard, *Reliance on Advice of Counsel as a Defense in Corporate and Securities Cases*, 62 Va. L.Rev. 1, 19 (1976).

Courts have uniformly recognized that in-house counsel are not "in a position to give . . . wholly disinterested advice" *Arthur Lipper Corp. v. Securities and Exchange Commission*, 547 F.2d 171, 182 (2d Cir. 1976) *cert. denied* 494 U.S. 1004 (1978). The opinions of Defendants' inside counsel "must be discounted". *Universal Athletic Sales v. American Gypsum*, 546 F.2d 530, 539-40 (3d Cir. 1976). "Reliance . . . from a lawyer having a personal stake adverse to the shareholders affords no protection unless it is right—in which event it is unnecessary to assert the defense of reliance." *Fogel v. Chestnut*, 533 F.2d 731, 749 (2d Cir. 1975) *cert. denied* 429 U.S. 824 (1976).

It is undisputed that here, although outside counsel was utilized for certain limited purposes in connection with the MAC dividend (Corporate Defendants' Petition at pp. 5-6), such outside counsel never rendered any legal opinion that the MAC dividend transaction was lawful.[9]

[9] The law firm of Hunton and Williams, which was retained specifically to obtain a "no-action" letter from the Exchange Commission, was neither engaged nor requested to provide an opinion as to the legality of the restructuring transaction with respect to its effect on the B&O debentureholders. While, as the Trial Court found, Hunton and Williams "expressed *no objection* to the [MAC stock dividend] proposal" (emphasis added) (Corporate Defendants' Petition, p. 64a), in fact the firm never rendered any opinion—pro or con—as to the legality of the MAC stock dividend scheme.

Nor did Defendants' in-house counsel ever consider the legality of the transaction under the Exchange Act. They testified that their legal review was limited to the indenture, the listing agreement, Maryland law, and the New York Stock Exchange Manual. Corporate Defendants' Petition at p. 7.[3]

Therefore, Defendants' attempt to raise an advice of counsel defense is not supported by the record and is not properly before this Court.

B. Claimed reliance on advice of counsel does not provide proof of a lack of intent to defraud.

In private damage actions under §10(b) of the Exchange Act, all the Courts have uniformly rejected the defense of advice of counsel. Quite simply, in this case, as in *Arthur Lipper Corp. v. Securities and Exchange Commission, supra*, 547 F.2d 171, 182-83:

> "It is no answer that petitioners may not have realized that this "cunning device" was a fraud.
>
> We likewise reject petitioners' argument that there was no violation of Rule 10b-5 because they acted on the advice of their counsel, Mr. Conwill. . . . Petitioners' reliance on his advice goes not to the violation but to the penalty".

See also *Securities and Exchange Commission v. Falstaff Brewing Corp.*, 629 F.2d 62, 77 (D.C.Cir. 1980)

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[3] Even Commissioner Bevis Longstreth—whose speech is heavily relied on by the Corporate Defendants (Petition, pp. 14-15) agrees that under the facts of *this* case a reliance on counsel defense lacks merit. See SEC counsel Stillman's January 24, 1982 letter to the Court of Appeals attached hereto as Exhibit "A" wherein it is stated "under the circumstances of this case as found by the District Court the Defendants reliance on advice of counsel is not a defense to violations of Sections 10(b) and Rule 10b-5".

cert. denied 449 U.S. 1012 (1980) and *Securities and Exchange Commission v. Savoy Industries, Inc.*, 665 F.2d 1310, 1314 n. 28 (D.D.C. 1981) ("Compliance with federal securities laws cannot be avoided simply by retaining outside counsel . . .").

Defendants herein raise the claim of reliance on advice of counsel in an attempt to defeat a finding of the requisite intent to deceive.

All parties agree that under *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), a Court must consider the definition of the words "intent" and "deceive" since Rule 10b-5 is limited "to knowing or intentional practices" (footnote omitted). *Id.* at 197-98.

"Intent" is defined as "embracing either the specific requirement of purpose or the more general one of knowledge or awareness." *United States v. United States Gypsum Co.*, 438 U.S. 422, 445 (1978) quoting W. LaFave & A. Scott, *Criminal Law* 196 (1972) as follows:

> "[I]t is now generally accepted that a person who acts (or omits to act) intends a result of his act (or omission) under two quite different circumstances: (1) when he consciously desires that result, whatever the likelihood of that result happening from his conduct; and (2) when he knows that the result is practically certain to follow from his conduct, whatever his desire may be as to that result." *Id.* at 445.

With reference to the meaning of the word "deceive":

> ". . . *Webster's New International Dictionary* (2d Ed. 1934) defines "deceive" as inter alia: "to cause to believe the false, or disbelieve the truth." "Deceptive" means "tending to deceive; having the power

> to mislead; as, a deceptive appearance." *Id.* "To deceive," then, refers to the *effect* of conduct on the observer; "deceptive", on the other hand, refers more to a *quality* of the conduct itself, to wit, its *propensity* to deceive. (Footnote omitted) *Klamberg v. Roth*, 473 F.Supp. 544, 550 (S.D.N.Y. 1979).

In this case, Defendants intended to conceal the MAC dividend from Plaintiffs and had knowledge that, if Plaintiffs did not receive advance notice of the MAC dividend, they would lose the opportunity to participate in the development of the B&O's non-rail assets. Defendants had the requisite intent to deceive, and the claimed reliance on the advice of counsel is patently irrelevant.

II. Defendant issuing corporation and its majority shareholders and directors breached a duty to convertible debentureholders by depriving them of a meaningful opportunity to exercise their conversion rights through concealment of the impending MAC dividend.

Defendants principally rely on the Fifth Circuit decision in *Broad v. Rockwell*, 642 F.2d 929 (5th Cir. 1981) (*en banc*) *cert. denied* 454 U.S. 965 (1981) to support its allegation that the Third Circuit failed to follow this Court's "duty" criteria in *Chiarella v. United States*, 445 U.S. 222 (1980). However, *Broad* supports the Plaintiffs', not the Defendants', legal position. In *Broad*, 642 F.2d at 958, defendant Rockwell *conceded* a fiduciary relationship with its convertible debentureholders.[4]

[4] Compare and contrast a broker's duty to third parties when they trade. L.Loss, 3 *Securities Regulations*, §1483 (2d Ed. 1961) ("the theory is that even a dealer at arm's length impliedly represents, when he hangs out his shingle, that he will deal fairly with the public. . ."). Defendants herein fail to admit that when they "hang out" their debentures for public trading, they too have a duty to act fairly. *Cf. Chiarella v. United States*, 445 U.S. at 226-28, expressly recognizing that the customary duties of corporate directors to security holders can provide a basis for the duty of disclosure.

Whether or not a duty to disclose exists under §10(b) of the Exchange Act is only resolved by a careful consideration of numerous factors. See, *e.g.*, *Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808, 813 (9th Cir. 1981) wherein the Court recently held:

> "... [T]he scope of a defendant's duty under Rule 10b-5 should be determined by considering five factors: (1) the relationship of the defendant to the plaintiff; (2) the defendant's access to information, compared to that of plaintiff; (3) the benefit the defendant derived from the relationship; (4) the awareness by the defendant of the plaintiff's reliance on him or her; and (5) the defendant's activity in initiating the securities transaction in question." (footnote omitted) *Id.* at 813.[5]

Corporate duties may even extend to creditors. *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971).

After considering the above factors, the Court of Appeals here correctly held, as did the Court in *Broad*, that a corporation owes its convertible debentureholders a "duty of good *faith and fair dealing*". (Emphasis added) *Broad*, 614 F.2d at 430, *aff'd* on this point 642 F.2d at 958.

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[5] In dissenting, Judge Adams contended you are only entitled to receive what you "bargained for" (49a). Such a principle was not even the common law, but only the law "where the means of intelligence [were] equally accessible to both parties ..." *Laidlaw v. Organ*, 15 U.S. (2 Wheat) 177 (1817). Also see *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972) recognizing that the Exchange Act's basic purpose was "to substitute a philosophy of full disclosure for the philosophy of caveat emptor...". *Id.* at 151.

A. An indenture notice clause referring to "any dividend on [the issuer's] common stock payable in stock" requires advance notice to the convertible debentureholders of a dividend on the issuer's stock, payable in stock of a subsidiary of the issuing company.

In *Broad v. Rockwell*, 642 F.2d 929 (5th Cir. 1981) (*en banc*) *cert. denied* 454 U.S. 965 (1981) plaintiffs were holders of convertible debentures issued by Collins Radio Company. In 1973, after having acquired 75% of the outstanding Collins common stock by a tender offer, Rockwell affected a short-form merger upon the non-tendering minority shareholders. In connection with the merger of Collins into Rockwell, Rockwell assumed Collins' obligation to its debentureholders and entered into a supplemental indenture agreement with the indenture trustee, providing that debentureholders would have the right to convert into the same thing (cash) which holders of Collins common stock received in the merger. The debentureholders claimed, in part, that defendants' failure to disclose a material fact (*i.e.*, that in the event of a merger, plaintiffs' conversion rights would be the same as that of shareholders) was a violation of §10(b) of the Exchange Act. *Id.* at 960. The Court, in *Broad*, rejected the plaintiffs' legal position and found that the indenture "unambiguously sets out the conversion rights of the holders of the Debentures in the event of a merger. . ." (p. 955) and that it "was available to anyone who cared to look at the indenture". *Id.* at 960. The Court in *Broad* concluded that there was no fraud or deception, because Defendants "merely carried out their contractual obligations". *Id.* at 963.

In this case Plaintiffs have consistently maintained that the B&O Indenture (Article V, Section 12) explicitly

required advance notice to the debentureholders of the MAC dividend. While Defendants dispute this[6] and neither of the prevailing opinions below addresses that point, this state law issue could become a threshold question should this Court undertake a review of the merits.

Even accepting, however, the Defendants' position that the Indenture is silent on that subject, *Broad* still does not support Defendants' position in this case. *Broad* held that the defendants' conduct was *mandated* by the indenture. Defendants here can point to no such mandate. Moreover, in this case the Indenture, if read as not explicitly requiring notice of the dividend, should be deemed enlarged or superseded by the notice provisions of SEC Rule 10b-17 and the Listing Agreement; see Exchange Act, §29 ("Validity of Contracts").[7]

In addition, Defendants overlook the crucial fact that the Court in *Broad* was concerned with a substantial right "inherent in the investment" to obtain only cash upon a merger, as opposed to an "unsatisfactory notice procedure". *Broad*, 642 F.2d at 957-58 quoting *Van Gemert v. Boeing Co.*, 520 F.2d 1373, 1385

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[6] The narrow question is whether the Indenture phrase "dividend on [B&O's] common stock payable in stock" encompasses the MAC dividend, as Plaintiffs contend, or only a dividend in B&O's shares, as Defendants contend.

[7] Moreover, in *Broad*, debentureholders were entitled to recover on conversion exactly what the common shareholders received. In contrast, here, the B&O debentureholders were foreclosed from recovering on conversion what the B&O common shareholders received, *i.e.*, the MAC shares.

(2d Cir. 1975) *cert. denied* 423 U.S. 947 (1975).[8] In this case, unlike *Broad*, but like *Van Gemert*, the plaintiffs are concerned about an "unsatisfactory notice procedure."

There is no conflict between the Fifth Circuit's decision in *Broad* and this case. In this case, as in *Broad*, certiorari should be denied.

B. For purposes of Rule 10b-5, Rule 10b-17 entitles holders of publicly traded debentures to advance notice of dividends on the issuer's stock.

Defendants' view of their advance notice duty is myopic.

Plaintiffs argued in the Courts below that there were at least four independent sources of duty that the Defendants violated when they failed to give them advance notice:

1. Defendants' indenture;
2. Defendants' listing agreement;
3. Maryland statutory law; and
4. Section 10(b) of the Exchange Act.

Plaintiffs contended, *inter alia*, that under Rule 10b-17, Defendants had a duty to speak, and that the breach of that duty was fraudulent under Rule 10b-5.

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[8] The importance of meaningful notice to the convertible debentureholders is well recognized.

> "[T]he debentureholder relies on the opportunity to make a proper conversion on due notice. Any loss occurring to him from failure to convert, as here, is not from a risk inherent in his investment but rather from unsatisfactory notice procedures." *Broad*, 642 F.2d at 957-58 quoting *Van Gemert*, 520 F.2d at 1385.

And "inadequate notice . . . to debentureholders may render valueless the investors' interest" (footnote omitted) *State Teachers Retirement Bd. v. Fluor Corp.*, 654 F.2d 843, 854 (2d Cir. 1981).

Judge Gibbons, announcing the judgment of the Court, held that Defendants had a "duty to speak" under "[1] Rule 10b-17, [2] the Maryland law of fiduciary obligations and [3] the New York law of contracts [indentures]" (19a).[9] Judge Garth, concurring in part, held that he would "predicate [Defendants'] duty to disclose the [MAC] dividend solely on the provisions of Rule 10b-17 . . ." (23a) and therefore did not find it necessary to decide whether a duty to disclose arose from other sources.[10]

Defendants request this Court to grant certiorari and hold that Defendants had no duty to disclose under Rule 10b-17. Plaintiffs respectfully submit that since Defendants' duty under Rule 10b-17 is clear, further consideration by this Court or the Court of Appeals on whether a duty under the indenture, listing agreement, or the law of Maryland exists is unwarranted.

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[9] Judge Gibbons also noted that the "convertible debentures were listed on the NYSE, and that the listing agreement applicable to them imposed on B&O the affirmative duties . . .(b) to 'afford holders of its securities listed on the Exchange [a] proper period within which to record their interests and exercise their rights.'" (17a) Judge Gibbons, however, declined to look to the listing agreement as a source of the duty owed to Plaintiffs. (19a)

[10] Judge Garth found it unnecessary to consider "the question whether the Defendants had a duty to disclose under the New York Stock Exchange (NYSE) listing agreement, the Maryland law of fiduciary obligations, or the New York law of contracts." (23a) Also see 29(a). However, he did state that the Defendants' listing agreement was applicable to this case: "By its terms, the NYSE listing agreement unquestionably includes any action taken, including the distribution of dividends, which affects convertible debentures." (26a, n. 3)

An analysis of Rule 10b-17

Rule 10b-17, entitled "Untimely announcements of record dates", provides that notice must be given to the Exchange ten days prior to the declaration of a dividend relating to any publicly traded security.[11] The failure to provide this notice constitutes a "manipulative or deceptive device" within the prohibitions of Section 10(b). Rule 10b-17 provides *inter alia:*

> (a) It shall constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the Act for any issuer of a class of securities publicly traded by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange to fail to give notice in accordance with paragraph (b) of this section of the following actions relating to such class of securities:
>
> > (1) A dividend or other distribution in cash or in kind, except an ordinary interest payment on a debt security, but including a dividend or distribution of any security of the same or another issuer;

The Commission releases issued when Rule 10b-17 was proposed indicate that the notice requirement was to protect purchasers (like Plaintiffs) and sellers of all publicly traded securities. See Securities Exchange Act Rel. No. 9076, 36 Fed. Reg. 3431 (February 17, 1971) (Purpose of Rule 10b-17 was "to require companies whose securities are publicly traded to furnish public investors with timely advance notice of the right to receive dividend and

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[11] This Court, in finding no duty in *Chiarella*, attributed significance to the fact that neither Congress nor the Commission had ever promulgated a general "parity of information rule", 445 U.S. at 233. Here, the Commission has promulgated a rule (Rule 10b-17) governing the exact situation presented by this case.

other rights which accrue to holders of record"). The Commission also noted that "belated declarations of . . . dividends [could have] a manipulative effect on the market". See also Securities Exchange Act No. 9192, 36 Fed. Reg. 11513 (June 7, 1971) ("[T]he failure to make a timely announcement of the record date has had a misleading and deceptive effect on both the broker-dealer community and the investing public.")[12]

Defendants contend that Rule 10b-17 is not applicable to this case for at least four reasons:

First: Since the MAC dividend was declared on the non-publicly traded B&O common stock, Rule 10b-17 is inapplicable.

Answer: The convertible debentures are publicly traded securities. The MAC dividend was "relating to" the publicly traded convertible debentures of the B&O.[13]

Second: The Rule 10b-17 duty to speak issue was not raised before the Trial Court.

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[12] Judge Adams would limit Rule 10b-17 to a mere recordkeeping requirement. (46a-48a). However, the Commission's primary purpose in promulgating that rule was to prevent fraud, as is apparent from the Rule itself which defines the failure to give notice as a "manipulative or deceptive device" *per se*. That Rule clearly falls within the "catch-all" provisions for fraud in §10(b) of the Exchange Act. *Chiarella, supra*, 445 U.S. at 234-35.

[13] In this case as in *State v. Gaddy*, 184 N.E.2d 689 (Ohio Com. Pl. 1962):

> "• • • it is commonly understood that 'relating to' embraces much more than such words as 'directly connected to' or 'a part of'. We constantly use the words 'relating to' in many circumstances where time and again we find an event or a status often leading to or in our experience being followed by a common consequence."

Answer: The Rule 10b-17 duty issue was raised *before* trial [Plaintiffs' Brief In Support Of Motion For Summary Judgment, p. 13] as well as immediately *after* trial in Plaintiffs' Proposed Conclusions of Law, p. 9. The Rule 10b-17 duty was fully, completely and forcefully presented to the Trial Court.[14]

Third: Rule 10b-17 does not create any duty owed to Plaintiffs, but only to the Exchange.

Answer: Duties owed to the Exchange are relevant in determining standards of disclosure under §10(b) and Rule 10b-5. *Peacock v. Oppenheimer & Co.*, 1981 Fed.Sec.L.Rep. (CCH) ¶98,212 (N.D. Ill. 1981) citing *Miley v. Oppenheimer Co.*, 637 F.2d 318, 333 (9th Cir. 1981) and numerous other cases. See also *O'Connor & Assoc. v. Dean Witter Reynolds, Inc.*, 529 F.Supp. 1179 (S.D.N.Y. 1981) "[U]nder the *Newmann* [664 F.2d 12 (2d Cir. 1981)] rationale, because their trading . . . breached fiduciary duties owed to other parties, the alleged conduct constituted a fraudulent practice within the meaning of the securities laws." *Id.* at 1185).

Fourth: Rule 10b-17 does not create a private cause of action.

Answer: Plaintiffs have never claimed that Rule 10b-17 creates a private cause of action. Plaintiffs claim only that Rule 10b-17 sets forth a standard upon which to judge Defendants' conduct under Rule 10b-5. Therefore this Court's private right of action cases like *Transamerican Mortgage Advisors Inc. v. Lewis*, 444 U.S. 11 (1979) and

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[14] Moreover, at the discretion of the Court of Appeals a purely legal issue may be considered for the first time on appeal. *Singleton v. Wulff*, 428 U.S. 106, 121 (1976) and *Commonality Frat. Trad. Comm'n v. Co. Petro Marketing*, 680 F.2d 573, 581 (9th Cir. 1982).

Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) are inapplicable. As noted by the Court of Appeals "we do not look to . . . Rule 10b-17, the Maryland law of fiduciary obligations and the New York law of contracts as sources of independent causes of action . . . we look to them as sources of a duty to speak. . ." (19a). This is consistent with the analysis in *Chiarella* where this Court looked to common law fiduciary principles, not as an independent cause of action, but as the source of a duty to speak, breach of which could lead to Rule 10b-5 liability.

Plaintiffs had the right to rely on "the protection of certain Exchange requirements." *Sonesta Int'l Hotels Corp. v. Wellington Associates*, 483 F.2d 247, 254 (2d Cir. 1973). Or as stated by the Court in *Van Gemert v. Boeing Co.*, 520 F.2d 1373, 1381 (2d Cir.) *cert. denied* 423 U.S. 947 (1975):

> [I]t is held out to the investing public that by dealing in securities listed on the New York Stock Exchange the investor will be dealt with fairly and pursuant to law. This would be particularly true as to the convertible securities market which differs from the market for other corporate debt in that it is composed primarily of individuals. (Emphasis added)

Likewise, the Plaintiffs had the right to rely on the duties owed the Exchange on listed securities, *i.e.*, the duty to provide notice to the Exchange (as mandated by Rule 10b-17), which notice would then have been disseminated to the public.[18] Defendants' violation of Rule 10b-17 was fraudulent under Rule 10b-5.

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[18] As succinctly stated by the Court of Appeals in *Van Gemert v. Boeing Co.*, *supra*, 520 F.2d at 1383:

> What one buys when purchasing a convertible debenture in addition to the debt obligation of the company incurred thereby is

(Footnote continued on following page)

III. This Court's opinion in *Blue Chip Stamp v. Manor Drug Stores* (holding that the owner of a contractual right to purchase is a statutory purchaser) was correctly applied.

In *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), this Court emphasized that "the wording of §10(b), making fraud *in connection with the purchase or sale of a security* a violation of the Act, is surely strained when construed to provide a cause of action, not to purchasers or sellers of securities, but to the world at large." (Emphasis added) *Id.* at 733, n. 5. But this Court went on to recognize that a party with a *contractual* right to purchase has standing as well as an actual purchaser:

> [The Court of Appeals] noted that prior cases have held that persons owning contractual rights to buy or sell securities are *not* excluded by the *Birnbaum* rule. (Emphasis added) *Id.* at 749.

This Court explicitly commented on the difference, under §10(b), between a person with and a person without a contractual right to purchase:

> A contract to purchase or sell securities is expressly defined by §3(a) of the 1934 Act, 15 U.S.C. §78c(a) [15 U.S.C. §78c(a)(13)] as a purchase or sale of

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(Footnote continued from preceding page)

> principally the expectation that the stock will increase sufficiently in value that the conversion right will make the debenture worth more than the debt. *The debentureholder relies on the opportunity to make a proper conversion on due notice... The debentureholder's expectancy is that he will receive reasonable notice and it is his reliance on this expectancy that the courts will protect.* (Emphasis added)

The conduct of the Defendants in this case violated the Defendants' duty to provide convertible debentureholders with the notice necessary to enable them to make use of the conversion right for which they had paid.

> securities for the purposes of that Act. *Unlike respondent, which had no contractual right or duty to purchase Blue Chip's securities, the holders of puts, calls, options, and other contractual rights or duties to purchase or sell securities have been recognized as "purchasers" or "sellers" of securities for purposes of Rule 10b-5*, not because of a judicial conclusion that they were similarly situated to "purchasers" or "sellers", but because the definitional provisions of the 1934 Act themselves grant them such a status. (Emphasis added) (Footnote omitted) *Id.* at 750-51.

Also see *Camp v. Genesco*, [1976-77] Fed.Sec.L.Rep. (CCH) Para. 95,473 and Para. 95,679 (S.D.N.Y. 1976).

As holders of convertible debentures Plaintiffs have a contractual right to acquire B&O common stock, and are therefore granted the status of "purchasers" for the purposes of Rule 10b-5 by the definitional provisions of the Act of 1934. The fact that Plaintiffs have not yet redeemed or sold their debentures does not affect their protection under Rule 10b-5 as thwarted purchasers. Moreover, Defendants' conduct, which deprived Plaintiffs of a meaningful opportunity to "purchase" B&O stock and to participate in the MAC dividend, constituted fraud "in connection with the purchase or sale of any security." See Rule 10b-5. For purposes of this case—substituting the statutory definition of "purchase" contained in §3(a) of the Exchange Act, 15 U.S.C. §78(c)(a)(13)—the issue may be stated as follows: Whether the acts or omissions of Defendants operated as a fraud upon Plaintiffs "in connection" with a "contract to buy, purchase, or otherwise acquire" an equity security.

This Court's opinion in *Blue Chip Stamp & Manor Drug Stores* was correctly applied.

Conclusion

There is no conflict between this case and any other appellate court decision. The Court's standards for determining scienter, duty and standing were followed by the Court of Appeals. The petitions for certiorari should be denied.

Respectfully submitted,

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(Seal)

EXHIBIT A

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

January 24, 1982

Sally Mrvos, Clerk
United States Court of Appeals
for the Third Circuit
21400 United States Courthouse
Independence Mall West
601 Market Street
Philadelphia, PA 19106

Re: *Pittsburgh Terminal Corp., et al.* v. *The Baltimore & Ohio Railroad Co., et al.*, Nos. 81-1674, 81-1675, 81-1976

Dear Ms. Mrvos:

Pursuant to Rule 28(j) of the Federal Rules of Appellate Procedure, the Securities and Exchange Commission, which filed an *amicus curiae* brief in this case, submits this letter in response to a letter of January 18, 1982 submitted by the appellees. Enclosed with the appellees' letter was a copy of a speech given on December 4, 1981 by Securities and Exchange Commissioner Bevis Longstreth, as reprinted in the CCH Federal Securities Law Reporter at ¶ 83,063. The appellees' letter states that in his speech Commissioner Longstreth "disavowed the position expounded by counsel for the SEC in its *Amicus* Brief."

Exhibit A—Letter Dated January 24, 1982.

Contrary to the suggestion implicit in appellees' reference to "the position expounded by counsel for the SEC," the views expressed in the Commission's *amicus curiae* brief are those of the Commission itself, which determined to participate *amicus curiae* in this case and reviewed the brief.

In addition, Commissioner Longstreth's speech dealt with only one of the issues addressed in the Commission's brief—reliance on advice of counsel. And even with respect to that issue, it is clear from his speech—and he has authorized us to state—that his views differ from those in the Commission's brief only with respect to whether reliance on advice of counsel is relevant in an omissions case where the advice goes to the existence of a legal duty to disclose. Commissioner Longstreth has also authorized us to state that he agrees with the position in the Commission's brief that a reliance-on-counsel defense is unavailable where counsel's advice was not disinterested or was incomplete, and that he agrees with the brief's ultimate conclusion that, under the circumstances of this case as found by the district court, the defendants' reliance on advice of counsel is not a defense to violations of Section 10(b) and Rule 10b-5.

Finally, Commissioner Longstreth has asked us to point out that his speech, as printed in the official Commission News release (a copy of which is enclosed), contains the following qualification in a footnote on the first page:

Exhibit A—Letter Dated January 24, 1982.

"The views expressed in this paper are my own and do not necessarily represent those of the Commission, my fellow Commissioners, or the staff."

CCH failed to include that qualification in its reprint of the speech.

I am enclosing three additional copies of this letter and of the Commission News release containing Commissioner Longstreth's speech.

Sincerely,

JACOB H. STILLMAN
Jacob H. Stillman
Associate General Counsel

Enclosures

cc (w/encl.):

Richard T. Wentley, Esq.
Robert B. Block, Esq.
John J. Repcheck, Esq.
Leonard M. Mendelson, Esq.
Michael P. Malakoff, Esq.